The Tax Court’s View on Appraising Subsidized Housing

What Influences a Buyer of Subsidized Housing ?

- **Advantages to Property Owners**
  - **Low-Income Housing Tax Credits (influx of cash)**
  - **Subsidized Rent Payments Based on Tenant Income**
  - **Financing Assistance (low-interest, favorable repayment terms)**
  - **Low Vacancy**
- **Disadvantages to Property Owners**
  - **Rent Restrictions (set by government)**
  - **Restrictions on Use (must make available to low-income tenants)**
  - **Restrictions on Distributions/Profits**
  - **Sale Subject to Restriction Associated with Program (approval of buyer)**

Low Income Housing Tax Credits (LIHTC)

<u>The LIHTC/Section 42 of the Internal Revenue Code</u>

- **Provides funding for the development costs or rehabilitation costs of low-income rental housing (developer's fee)**
- **Investors purchase the credits from developers to provide a capital contribution to the project**
- **The LIHTC is allocated over a 10-year period of time.**
- **Rents are capped for low income tenants**
- **Restrictions in place for 15-30 years**

Maryland Assessment Procedures Manual

- **Government Subsidized Housing**
  - **LIHTC is the most common; however, projects have received benefits from other programs: low-interest rate financing, non-repayment loan provisions, limited dividend restrictions, housing assistance payment contracts, regulatory qualifications for low-income tenants.**
  - **Specific terms and agreements will vary greatly**
  - **To make valuation uniform, these projects will be assessed as outlined for Section 42 projects**

Section 42 Valuation

- Rent restrictions for 30 years: potential recapture by IRS for 15, enforced by DHCD for remaining 15 years
- Properties often require high than normal maintenance and other expenses – often exceeding 60%
- Assessors are REQUIRED to apply an income approach:
    - Consider rent restrictions
    - May NOT consider income tax credits
    - May consider replacement cost approach only if the value is less than income approach
    - 5% vacancy recommended or actual
    - Actual expenses considered
    - Expenses capped at 70% - except when otherwise documented
    - Cap rates should be 150 to 200 basis points higher

What if LIHTC and Cap on Distribution?

Recent Case:

- 178 apartments (1971) - PTAAB valued at $7.9 million – DOF 1/1/2015
- 2005 owner paid $4 million and spent $4 million in renovations
- received $3.5 million in LIHTC and one time developer's fee of $1.5
- When purchased, property governed by LIHPRHA loan program : restricts distributions to owners to $175k per year for 50 years – until 2044.

Questions:

- Which approach: income approach, discounted cash flow, other?
- If income approach, what cap rate?
- Expenses? Actual (about 70%) or other?
- How is distribution restriction addressed?
- Past tax credits considered? What if buyer could receive tax credits?

Tax Court Result

- Petitioner's used a discounted cash flow – calculated $125,000 until 2044 and calculation reversion value – arrived at $2 million
- Supervisor used income approach – cap rate for 2nd tier + 200 basis (9.2%) - used 66% for expenses – arrived at $ 7.9 million
- Court used Supervisor's approach – deducted more expenses (based on information provided for first time in hearing); increased cap rate to 11% (said it wasn't 2nd tier); then divided in half because of distribution cap – arrived at $2.2 million
- Judge commented that procedures should include a way to address a distribution restriction.

Other Subsidized Housing Cases/Restrictions on Distribution

- **2013 Case: Property developed under Dept. of Ag 515 mortgage program - $6,000 cash limitation per year for 50 years. The Court concluded: "The full cash value must reflect what a buyer would pay for this type of mortgage restricted property which has real earning potential but not until 2036."**
- **1986 Case: Section 8 housing, HUD guaranteed financing of 40 year 7.5% mortgage – HUD called for higher quality construction and are bound by rental policies. HUD subsidization applied to 25% of rental units. The Petitioner valued property without consideration for HUD related factors. Court stated,**

"If …it was only the income stream that was instrumental in a potential purchaser's decision to buy, there would exist little or no market for HUD financed projects. In order to reap any reasonable economic gain, a potential buyer must look past the present income stream to the tax benefits that are available through the assumption of HUD financing. Those purchasers who seek these benefits constitute the market for the subject properties."